Supreme Court, U.S.
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No. 96-1351

In The

Supreme Court of the United States

October Term, 1996

BERRY F. LAWS, III,
Successor Segregated Fund Trustee,

Petitioner,

v.

UNITED MISSOURI BANK OF KANSAS CITY, N.A.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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RESPONDENT'S RULE 29.6 STATEMENT

Respondent, now known as UMB Bank, N.A., is a wholly owned subsidiary of UMB Financial Corporation.

TABLE OF CONTENTS

Page

RULE 29.6 STATEMENT i

TABLE OF AUTHORITIES iii

STATUTES INVOLVED 1

STATEMENT OF THE CASE 1

REASONS FOR DENYING THE WRIT 6

I. THIS CASE DOES NOT PRESENT A CONFLICT OF OPINION BETWEEN THE CIRCUITS 7

II. THE $4 MILLION WIRE TRANSFER DEPOSIT WAS NOT AVOIDABLE BECAUSE UMB WAS FULLY SECURED 8

A. THE DEPOSITED CHECKS WERE NOT WORTHLESS 9

B. PETITIONER'S ARGUMENT IS CONTRARY TO FACT 11

CONCLUSION 12

APPENDIX

Mo.Rev.Stat. §400.4-210 (1994) 1A

Mo.Rev.Stat. §400.4-215 (1994) 2A

Mo.Rev.Stat. §400.4-301 (1994) 4A

Excerpts from Appellant's (petitioner herein) Brief filed with the Court of Appeals 6A

TABLE OF AUTHORITIES

Page

CASES:

In re Frigitemp Corp., 34 B.R. 1000 (S.D.N.Y. 1983), aff'd on other grounds, 753 F.2d 230 (2nd Cir. 1985) 4

In re Montgomery, 983 F.2d 1389 (6th Cir. 1993) 7

In re Smith, 966 F.2d 1257 (7th Cir. 1992) 7

Laws v. United Missouri Bank, 987 F.3d 1047 (8th Cir. 1996) 2, 7, 9

Laws v. United Missouri Bank, 188 B.R. 263 (W.D. Mo. 1995) 5, 9

STATUTES AND REGULATIONS:

11 U.S.C. §547(b) 4

11 U.S.C. §547(b)(5) 8, 11

Mo.Rev.Stat. §400.4-210 (1994) 1

Mo.Rev.Stat. §400.4-210(a)(1) (1994) 9

Mo.Rev.Stat. §400.4-210(c) (1994) 11

Mo.Rev.Stat. §400.4-215 (1994) 1, 2

Mo.Rev.Stat. §400.4-301 (1994) 1, 2

Reg. J, 12 CFR §210.4(12) 2

RULES:

Supreme Court Rule 10 ..... 6, 9

STATUTES INVOLVED

In addition to the statutes set forth in the Petition for Certiorari, the following statutes are also involved in this case:

U.C.C. § 4-210, Mo.Rev.Stat. § 400.4-210 (1994)
U.C.C. § 4-215, Mo.Rev.Stat. § 400.4-215 (1994)
U.C.C. § 4-301, Mo.Rev.Stat. § 400.4-301 (1994)

These statutes are reproduced in the appendix to this Brief in Opposition.

RESPONDENT'S STATEMENT OF THE CASE

Kroh Brothers Development Company (KROH), the debtor in the bankruptcy action, was a large national real estate development firm headquartered in Kansas City. It maintained accounts in several local banks including respondent (UMB). There is evidence that in 1986 KROH may have been using checking accounts in three Kansas City banks, including UMB, to conduct a check kite, although the issue has never been adjudicated. In 1986, the year in which the events giving rise to petitioner's claim occurred, KROH deposited checks totalling $350,013,388.71 into its UMB account and made 81 wire transfer deposits into the account totalling $45,911,347.33, with the wire transfer deposits ranging in size from $21,054.79 to $5.5 million. (App. pp. 246-48).[1] At no time in 1986 was KROH's account at UMB overdrawn. (App. p. 247). KROH had earlier borrowed money from UMB, but

[1] References are to the Joint Appendix filed by the parties in the Court of Appeals.

it had repaid its last loan on January 13, 1986. (App. p. 255).

In 1986 UMB followed the standard banking practice of allowing its commercial customers, including KROH, to draw on uncollected funds balances. Uncollected funds balances reflect checks drawn on other banks and deposited and provisionally credited to customers' accounts while the deposited checks are still in the collection process. UMB processed checks drawn on its customers' accounts on a deferred posting basis as established by the Uniform Commercial Code, Mo.Rev.Stat. §§ 400.4-215; 400.4-301 (1994)[2] and federal regulation, Reg. J, 12 CFR § 210.4(12). Under the deferred posting system, UMB had until 12:00 p.m. midnight of the banking day following its receipt of a check presented for payment, its midnight deadline, to pay the item or to return it unpaid to the Kansas City Clearing House for ultimate return to the collecting bank. See opinion below 98 F.3d at 1048.

On Friday, October 17, 1986, KROH deposited checks into its checking account at UMB totalling $4,041,449.64. KROH withdrew $12,000 from its account by wire transfer. In addition, at noon on October 17, the usual clearing hour for the Kansas City Clearing House, UMB was presented with checks drawn on KROH's account at UMB totalling $4,316,454.52. When the automated computer

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[2] When citing the U.C.C. the Court of Appeals cited to Mo.Rev.Stat. (1994). The 1986 version of the Revised Statute was in effect at the times relevant here. Missouri amended the U.C.C. in 1992. No material changes were made to the sections pertinent to this case. Some sections were renumbered. Mo.Rev.Stat. § 400.4-215 (1994) was Mo.Rev.Stat. § 400.4-213.

run was conducted after the close of business that evening the new account balance, which consisted of the account's opening balance plus deposits less the wire transfer, was inadequate to cover the items presented against the account. Because there were inadequate funds to pay the bunch of presented checks, the computer did not post the items to the account; instead it generated a memo advising the account officer of the problem. (App. pp. 249-50). UMB's midnight deadline for the October 17 presentments was midnight of the next banking day, Monday, October 20.

On Monday, October 20, 1986, a bank officer contacted KROH and informed it that additional funds would have to be deposited to its account that day or the October 17 presentments would be returned because of insufficient funds. KROH transferred $814,966 from another account it maintained at UMB to its checking account. That sum, plus the day's opening account balance which included the Friday deposits, was sufficient to cover the presentments of the 17th. (App. pp. 250-51; 258).

At noon on October 20, the Clearing House presented UMB with checks drawn on the KROH account totalling $4,915,678.51. During that day KROH deposited checks totalling $1,105,000. At 3:23 p.m., well after the $814,966 had been transferred to the KROH account, KROH wire transferred $4 million to its checking account at UMB from its checking account at Commerce Bank of Kansas City (App. pp. 250-51; 258). UMB's midnight deadline for that day's presentments was midnight of Tuesday, October 21. As part of the automated computer run following the close of business on October 20, a new balance was

calculated for the account which consisted of that day's opening balance plus the $814,966 transfer plus the $4 million wire transfer plus the checks deposited that day. That balance was sufficient to pay both the presentments of October 17 and those of October 20, so all of those items were posted to the account. (App. pp. 250-51). The KROH account balance at the end of the business day on October 20 included credits for checks written on other banks and deposited by KROH on October 16, 17 and 20. The midnight deadline for those checks had not yet passed, and they were subject to being returned to UMB. It is these deposits which constituted the "negative collected funds balances" which petitioner apparently now claims is the antecedent debt for purposes of 11 U.S.C. § 547(b).[3]

No notice came to UMB to inform it that a check deposited by KROH had been paid by the drawee bank; the ~~only~~ notice a bank would ordinarily receive in the check collection process is a notice of dishonor if an item is returned. As noted in *In re Frigitemp Corp.*, 34 B.R. 1000, 1015 (S.D.N.Y. 1983), aff'd on other grounds, 753 F.2d 230 (2nd Cir. 1985):

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[3] Petitioner has at various times in this litigation found the antecedent debt in (1) the "kite-debt", by which he apparently meant a debt which necessarily was created by operation of an alleged check kite; (2) the negative collected balance in KROH's account arising from its use of provisional credits it received for deposits; and (3) the provisional debits made to respondent's settlement account at the Federal Reserve Bank of Kansas City reflecting the presentment of items drawn on the KROH account. See the District Court's Order denying petitioner's Motion for Reconsideration at p. 3. (Petitioner's appendix at p. 34a).

> The [check] collection process works on the theory that 'no news is good news,' and the depository, collecting, and Federal Reserve banks each in turn grant provisional credits.

In fact, however, none of the checks deposited by KROH into its checking account at UMB at any time relevant to this litigation was ever returned, and all were paid in full by the drawee banks. (App. p. 249).

The allegedly preferential transfer which petitioner seeks to have avoided is the $4 million which was wire transferred to the KROH account at UMB on October 20. That transfer was made from KROH's checking account at Commerce Bank of Kansas City, another bank which petitioner contends was caught in KROH's kite. Earlier that day KROH had borrowed $7 million from Commerce Bank; those loan proceeds were disbursed into KROH's checking account at that bank. (App. p. 133). At 3:23 p.m. on October 20, KROH wired $4 million of those funds for deposit into its checking account at UMB.

Finally, although petitioner asserts in his petition that KROH was "obviously insolvent," that element of this preference action is highly contested and remains unresolved. As noted by District Judge Sachs in his Memorandum and Order:

> Issues relating to [debtor's insolvency] are still in discovery, but on 'hold' at [petitioner's] request.

Petitioner's appendix at p. 16a, 188 B.R. 263, 266 (W.D. Mo. 1995).

REASONS FOR DENYING THE WRIT

As noted by then Chief Justice Vinson in his speech to the American Bar Association on September 7, 1949, 69 S.Ct. at VI:

> The Supreme Court is not, and never has been, primarily concerned with the correction of errors in lower court decisions. In almost all cases within the Court's appellate jurisdiction, the petitioner has already received one appellate review of his case. The debates in the Constitutional Convention make clear that the purpose of the establishment of one supreme national tribunal was, in the words of John Rutledge of South Carolina, 'to secure the national rights & uniformity of Judgmts.' The function of the Supreme Court is, therefore, to resolve conflicts of opinion on federal questions that have arisen among lower courts, to pass upon questions of wide import under the Constitution, laws, and treaties of the United States, and to exercise supervisory power over lower federal courts.

See also this Court's Rule 10. The Court of Appeals correctly decided the issues presented by this case. However, even if the District Court and the Court of Appeals erred, petitioner has failed to advance any reason sufficient to warrant this Court's review. He can point to no conflict among the lower courts and he has failed to raise any question of wide import arising under the Constitution or laws of the United States. However interesting the legal questions advanced here, they are clearly of importance only to the parties. Petitioner may feel aggrieved, but he has raised no issue of general importance requiring this Court's attention; he only seeks to have a second

appellate review of the District Court's decision to grant summary judgment.

I. THIS CASE DOES NOT PRESENT A CONFLICT OF OPINION BETWEEN THE CIRCUITS

In its opinion in this case the Court of Appeals stated, " . . . [W]e conclude that routine advances against uncollected deposits do not create a 'debt' to the bank." 98 F.3d 1047 at 1051. Petitioner claims that this conclusion conflicts with opinions of the Sixth and Seventh Circuits, *In re Montgomery*, 983 F.2d 1389 (6th Cir. 1993); *In re Smith*, 966 F.2d 1257 (7th Cir. 1992). Therefore, claims petitioner, this Court should grant its writ. The cases clearly are not in conflict. The Eighth Circuit carefully considered and distinguished *Montgomery*, 98 F.3d at 1051 n 4. *In re Smith*, which does not involve an attempt by the trustee to avoid a bank deposit, raises an entirely different issue.

More important, however, is the fact that the conclusion which petitioner contends conflicts with opinions of the Sixth and Seventh Circuits is mere dictum. As the Court of Appeals here noted, but petitioner has ignored, 98 F.3d at 1051-52:

> When KROH agreed to pay interest, its negative collected funds balance began to reflect a banking relationship having many indicia of a loan. Had KROH and UMB explicitly agreed to convert future negative collected funds balances into loans, KROH would have been legally bound to pay such debts as incurred. Whether such an agreement may here be implied is a disputed issue of material fact. Thus, while we arrive at this conclusion by a different analysis,

> we agree with the district court that *UMB was not entitled to summary judgment on the issue of whether the $4 million transfer satisfied KROH's antecedent debt to UMB.* (Emphasis added).

Thus, regardless of what the Eighth Circuit held to be the rule in the "routine" situation, that rule was not applied in this case. Even if this Court were to grant its writ and determine that the Eighth Circuit was wrong when it stated that routine advances on uncollected funds balances do not create a debt for bankruptcy purposes, the result of this case would be unaffected.

Petitioner is requesting this Court to issue its writ to review *obiter dictum*. The issue is not one of wide import under the Constitution and laws of the United States; it is not even an issue which, if decided differently, would dictate a different result in this litigation. Clearly, petitioner has failed to cite any conflict between the circuits which this Court should resolve.

II. THE $4 MILLION WIRE TRANSFER DEPOSIT WAS NOT AVOIDABLE BECAUSE UMB WAS FULLY SECURED

Both the District Court and the Court of Appeals held that even if there were a debt owed by KROH to UMB, petitioner could not avoid the $4 million wire transfer deposit because UMB was fully secured under the Uniform Commercial Code, and thus the transfer did not enable UMB to receive more than it would have received under a Chapter 7 liquidation if the transfer had not been made. 11 U.S.C. § 547(b)(5). The Court of Appeals was absolutely correct in its ruling on this issue. However,

even if that Court erred, petitioner has made no attempt to explain why this is a question deserving of this Court's review. Petitioner does not contend that the Court of Appeals' conclusion is at odds with any other federal or state opinion. Indeed, petitioner fails to even attempt to explain how this issue relates to the grounds for issuance of a writ suggested in this Court's Rule 10. Petitioner's argument with respect to this question presented in his petition makes it clear that he has no compelling reason which would justify the issuance of this Court's writ of certiorari. Petitioner has simply lost his case and is now seeking a further appellate review.

A. The Deposited Checks Were Not Worthless.

Both the District Court and the Court of Appeals held that UMB had a security interest in the deposited checks and their proceeds to the extent "to which credit given for the item has been withdrawn or applied; . . . " Mo.Rev.Stat. § 400.4-210(a)(1) (1994) [U.C.C. § 4-210(a)(1)].[4] Petitioner does not argue with this holding. Rather he claims that UMB's security interest was in kited checks which were, by his definition, valueless. Thus, he argues the $4 million transfer enabled UMB to receive more than it would have received had the transfer not been made because UMB could not have realized anything on its lien. This argument was specifically rejected by both the District Court and the Court of Appeals. 98 F.3d at 1052[6]; petitioner's appendix pp. 22a, *et seq.*; 32a *et seq.*

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[4] Mo.Rev.Stat. § 400.4-210(a)(1) (1994) was Mo.Rev.Stat. § 400.4-208(a)(1) (1986).

Petitioner's argument turns on the assumption that when the $4 million was deposited in the KROH account at UMB on October 20, 1986, there was an ongoing kite. In fact there was not. UMB's expert testified in his deposition that if there was a check kite, it had been resolved by the deposit of the $7 million dollars in loan proceeds in the KROH checking account at Commerce Bank (App. p. 874-75). Petitioner's own accounting expert did not challenge this proposition, rather he adopted it. Indeed, petitioner, quoting from his own expert's report in his brief filed in the Court of Appeals, conceded that the check kite was eliminated by the infusion of $7 million into the system. (Appellant's Br. p. 26 n. 8, Appendix p. 6A, infra.). Petitioner acknowledged at page 25 of his Eighth Circuit brief that, "[i]n this case, the kite never collapsed" (See Appendix p. 5A, infra.), and in at least three other places in that brief petitioner acknowledged that the kite was eliminated by the $7 million deposit to the Commerce account. (See Appellant's Br. pp. 6, 43, and 47, Appendix at pp. 5A-6A, infra.) That deposit was, of course, made prior to the wire transfer deposit to KROH's account at UMB. As petitioner admits, the $4 million was part of the loan proceeds and was wired out of the Commerce account in which it had originally been deposited. (App., p. 133).

Even if, as petitioner contends, kited checks have no value, that supposition has no relevance to this case. The alleged kite had been eliminated before the $4 million dollars was deposited at UMB. Thus, at the time of the wire transfer there were no kited checks and all of the items in which UMB had a statutory lien were backed by good funds.

B. Petitioner's Argument Is Contrary To Fact.

Petitioner's claim that the checks were worthless and that UMB's security was therefore valueless is simply contrary to fact. All of the checks deposited in the KROH account at UMB were paid; none was returned. UMB's U.C.C. 4-210 lien was in both the deposited checks and their proceeds. When those checks were presented to the drawee banks, UMB received provisional credits in their face amount and UMB's lien was then in those provisional credits. When the drawee banks posted those checks to their customers' accounts or when they allowed their midnight deadlines to pass, the checks were paid and that payment was a realization on UMB's lien. Mo.Rev.Stat. § 400.4-210(c).

Petitioner claims that both the District Court and the Court of Appeals misapplied 11 U.S.C. § 547(b)(5). Petitioner is again wrong. Sec. 547(b)(5) requires the Court to assume that no preferential transfer was made, but petitioner's analysis is not limited to the statute's commandment. He also demands that the Court hypothecate that the check kite collapsed. As noted above, however, by the time of the wire transfer there was no kite to collapse.

Even if petitioner's hypothesis is accepted, petitioner's argument fails and was correctly rejected by the District Court. As Judge Sachs noted in his Order denying petitioner's motion to reconsider (Appendix to Petition for Writ, pp. 33a-34a):

> Plaintiff's theory is also unsound in light of the presentment rules governing the October 17 and 20 transactions. Final settlement on the $4,316,464.52 October 17 presentment and the

> $4,915,678.51 October 20 presentment did not occur until midnight on October 21 and 22 respectively. Until this time, UMB had an absolute right to return these items to the clearinghouse for full credit. U.C.C. § 4-301. At the time of the challenged wire transfer, therefore, UMB was free to return the presentments to the clearinghouse and realize upon its security interest.

By October 20, the only deposits to the account subject to being returned to UMB unpaid were those of October 16, 17 and 20; the midnight deadline had already passed for earlier deposits. The deposits made on those three days totalled $9,098,479.64, $133,653.39 less than the amount of the checks UMB was entitled to return to their drawees. Thus, even if the $4 million was not transferred, UMB would not have suffered a loss; it was protected by its U.C.C. security interests in both deposited checks and their proceeds and in the checks presented for payment.

CONCLUSION

Petitioner does not and cannot suggest that the opinion of the Court of Appeals for the Eighth Circuit in this case conflicts with the opinion of any other court of appeals or of a state court of last resort. Likewise, petitioner does not and cannot suggest any issue of great import arising under the Constitution or laws of the United States raised in this case. Indeed, a review of the Court of Appeals' opinion establishes that it carefully and

correctly decided the case. There is no reason why this Court should grant its writ of certiorari.

Respectfully submitted.

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APPENDIX

Mo.Rev.Stat. § 400.4-210 (1994)

Security interest of collecting bank in items, accompanying documents and proceeds. – (a) A collecting bank has a security interest in an item and any accompanying documents or the proceeds of either:

(1) in case of an item deposited in an account, to the extent to which credit given for the item has been withdrawn or applied;

(2) in case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given whether or not the credit is drawn upon or there is a right of charge-back; or

(3) if it makes an advance on or against the item.

(b) If credit given for several items received at one time or pursuant to a single agreement is withdrawn or applied in part, the security interest remains upon all the items, any accompanying documents or the proceeds of either. For the purpose of this section, credits first given are first withdrawn.

(c) Receipt by a collecting bank of a final settlement for an item is a realization on its security interest in the item, accompanying documents and proceeds. So long as the bank does not receive final settlement for the item or give up possession of the item or accompanying documents for purposes other than collection, the security interest continues to that extent and is subject to Article 9, but:

(1) no security agreement is necessary to make the security interest enforceable (Section 400.9-203(1)(a));

(2) no filing is required to perfect the security interest; and

(3) the security interest has priority over conflicting perfected security interests in the item, accompanying documents or proceeds.

Mo.Rev.Stat. § 400.4-215 (1994)

Final payment of item by payor bank – when provisional debits and credits become final – when certain credits become available for withdrawal. – (a) An item is finally paid by a payor bank when the bank has first done any of the following:

(1) paid the item in cash;

(2) settled for the item without having a right to revoke the settlement under statute, clearing-house rule, or agreement; or

(3) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing-house rule, or agreement.

(b) If provisional settlement for an item does not become final, the item is not finally paid.

(c) If provisional settlement for an item between the presenting and payor banks is made through a clearing house or by debits or credits in an account between them, then to the extent that provisional debits or credits for the

item are entered in accounts between the presenting and payor banks or between the presenting and successive prior collecting bank seriatim, they become final upon final payment of the item by the payor bank.

(d) If a collecting bank receives a settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item and any provisional credit given for the item in an account with its customer becomes final.

(e) Subject to (i) applicable law stating a time for availability of funds and (ii) any right of the bank to apply the credit to an obligation of the customer, credit given by a bank for an item in a customer's account becomes available for withdrawal as of right:

(1) if the bank has received a provisional settlement for the item, when the settlement becomes final and the bank has had a reasonable time to receive return of the item and the item has not been received within that time;

(2) if the bank is both the depositary bank and the payor bank, and the item is finally paid, at the opening of the bank's second banking day following receipt of the item.

(f) Subject to applicable law stating a time for availability of funds and any right of a bank to apply a deposit to an obligation of the depositor, a deposit of money becomes available for withdrawal as of right at the opening of the bank's next banking day after receipt of the deposit.

Mo.Rev.Stat. § 400.4-301 (1994)

Deferred posting – recovery of payment by return of items – time of dishonor – return of items by payor bank. – (a) If a payor bank settles for a demand item other than a documentary draft presented otherwise than for immediate payment over the counter before midnight of the banking day of receipt the payor bank may revoke the settlement and recover the settlement if, before it has made final payment and before its midnight deadline, it

(1) returns the item; or

(2) sends written notice of dishonor or nonpayment if the item is unavailable for return.

(b) If a demand item is received by a payor bank for credit on its books, it may return the item or send notice of dishonor and may revoke any credit given or recover the amount thereof withdrawn by its customer, if it acts within the time limit and in the manner specified in subsection (a).

(c) Unless previous notice of dishonor has been sent an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section.

(d) An item is returned:

(1) as to an item presented through a clearing house, when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with clearing-house rules; or

(2) in all other cases, when it is sent or delivered to the bank's customer or transferor or pursuant to instructions.

Excerpts from Appellant's Brief
in the Eighth Circuit

Excerpt from page 6:

At the end of the day on Friday, October 17, the KBDC account at UMB had a negative collected balance of $4,215,278.20. [*App.* 250, *Waterman Aff.*, ¶15(b); *App.* 402-403, *Andersen Aff.*, ¶8; *App.* 410 (*Addendum: 1*); *App.* 503, UMB *Interrogatory Response*] On Monday, KBDC borrowed $7 million from Commerce Bank, and at 3:23 p.m., KBDC wire transferred $4 million of "good funds" to its account to UMB. [*App.* 627, *Wire Transfer Log*] The kite was stopped, and UMB had received $4 million in collected funds. . . .

Excerpt from page 25:

In this case, the kite never collapsed. On October 17, 1986, UMB demanded "good funds" and KBDC complied with the $4 million wire transfer before the kite ever "collapsed." [*App.* 564, 627] . . .

Excerpt from page 26:

[FN] [8] That is exactly the case here. As stated in the Arthur Andersen Affidavit: "During the existence of KBDC's check kite and prior to the $7,000,000 infusion into the system on October 20, 1986: a. KBDC's overdraft in its UMB account was concealed by UMB's posting of credits to KBDC's account for the deposit of worthless kited checks;. . . . " [*App.* 406, *Andersen Aff.*, ¶19] See also ¶¶15 and 16 of the affidavit stating the amount of the concealed overdraft on Friday and Monday. [*App.* 406]

Excerpt from page 43:

However, when one reviews the facts as sequential checks are floated through banks that pay against uncollected funds, it is impossible to find any "value" in the kite checks deposited by KBDC until KBDC injected millions of dollars of "good funds" into its accounts on October 20, thereby eliminating the kite.

Excerpt from page 47:

The fact that the kite was successful until KBDC bailed it out by injecting money on October 20 to pay the debt did not make the kited checks previously floated at UMB valuable. . . .